



How Much Mortgage Can You Afford?

When it comes to buying a home, one of the first questions you need to ask yourself is 'How much can I afford?' This is also the question that will be on the mind of your mortgage lender. She will use a series of calculations and formulas to come up with a figure, but you can do the same thing for yourself before you even start shopping around. This will give you a better idea of what types of home will be in your price range.

Figuring out just how much home you can afford involves numbers and ratios, but it should also involve understanding your own preferences and financial behavior. For example, a lender may qualify you for a large amount, but in order to make the monthly payments you would have to cut back a lot of your entertainment bill. Only you can decide whether or not the bigger house will be worth the lifestyle sacrifices you may have to make.

Once you have determined your own mortgage preferences, you need to look at your finances and resources from the perspective of a potential lender to figure out how much of a loan you can afford. Home loan lenders will lend you an amount of money based on how sure they are that you have the means and habits necessary to pay them back. In order to determine how much of a risk you are, they will look at several key factors: your income, your credit history, and your down payment.

Of course, mortgage loans are safer loans than most others for lenders. This is because you are pledging the home and property as collateral for the loan. If you should default on the mortgage, the lender will have the legal right to repossess the home and try to sell it to recover the amount of the money lent to you. Still, no lender really wants to have to go through that foreclosure process as it takes plenty of time and lots of money for lawyers' fees and paperwork. They would much rather go into the loan feeling confident that you will repay the loan.

So, a lender will start by looking at your sources of income. This will include not only your yearly salary, but any bonuses or commissions you receive. It will also include an inventory of your assets – the balances of your savings and investment accounts, and even the value of any cars or boats you own. This helps your lender to see what sources of wealth you could turn to repay your mortgage in crisis times.

Lenders also use ratios to determine if your income is sufficient for a certain loan amount. While standards vary by lender the general rule is the 28/36 ratio. The front end ratio, the 28, means that lenders like to see that your debts, excluding your housing payment, do not exceed 28 percent of your monthly income. So for example, if you make \$5,000 per month, your debts (student loans, credit card bills, etc.) should not be more than \$1400 (28 percent of \$5,000.) The back end ratio, the 36, means that your total debts, including a potential mortgage payment, should not exceed 36 percent of your monthly income. So using the same example above, 36 percent of your income would be \$1800. If you have monthly debts in the amount of \$700, you would have \$1100 left over for a monthly mortgage payment.

Lenders will also use your credit history as a means of determining whether or not to lend to you and how much interest to charge you. Obviously, the better your credit score the better the interest rate will be on your loan. If you have time and your score is not as high as you'd like it to be, start working now to improve it before you apply for a mortgage.



How much of a down payment you plan to make could also have an effect on how much you can afford or how much a lender will loan you. The bigger your down payment, the less risk the lender feels like he is taking on and you will probably receive a better rate, and of course you will pay less interest over time.

Don't worry; if this all of this seems a little complicated, you can visit almost any mortgage website to find helpful calculators that will figure it all out for you. The main point is to get a rough idea for yourself of your mortgage limits before you start shopping for a new home loan.